

Internal Revenue Service
Appeals Office
1000 South Pine Island Road
Suite 350
Plantation, FL 33324

Department of the Treasury

Person to Contact:

Employee ID Number:

Release Number: 201032053
Release Date: 8/13/2010

Date: May 20, 2010

UIL: 501.03-00

A = Org. Name

B = Org. Address

Refer Reply to:

AP:Area 4:Team 5:CD

In Re:

EO Revocation

EIN: C = EIN

UIL: 7428.00-00

Form Required to be Filed:

1120

Tax Period Ended:

Certified Mail

**Last Day to File a Petition with the
United States Tax Court:**

AUG 17 2010

Dear /Trustee:

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January 1, 2004.

Our adverse determination was made because we have determined you are not operated exclusively for exempt purposes described in section 501(c)(3). You have failed to establish that you are operated for a public purpose rather than for the benefit of private interests such as your Trustees and their family members. In addition, your net earnings have inured to the private benefit of one or more of your Trustees or Advisory Trustees. We have also determined, that even if you were described in section 501(c)(3), you are a private foundation described in section 509(a) rather than a supporting organization described in section 509(a)(3).

Section 1.501(c)(3)-1(d)(i) of the Income Tax Regs. provides that an "organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more" of named exempt purposes. Even if a Court concludes that no prohibited inurement of earnings exists, it cannot stop there but must inquire further and determine whether a prohibited private benefit is conferred. American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), *citing*, Aid to Artisans, Inc. v. Commissioner, 71 T.C. 202 (1978). Upon a conclusion that relevant facts reveal private benefit, the organization will not qualify as operating primarily for exempt purposes "absent a showing that no more than an insubstantial part of its activities further the private interests or any other nonexempt purposes." American Campaign Academy v. Commissioner, 92 T.C. at 1066.

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office.

Processing of income tax returns and assessment of any taxes due will not be delayed because you have filed a petition for declaratory judgment under Code section 7428.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed within 90 days from the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

A handwritten signature in dark ink, appearing to read "Charles Fisher", with a stylized flourish at the end.

Charles Fisher
Appeals Team Manager

cc:/

**Internal Revenue Service
Tax Exempt and Government Entities
Division 7850 SW 6TH COURT
PLANTATION, FL 33324**

Department of the Treasury

Date: 9/26/20XX

**ORG
ADDRESS**

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Telephone Number:
Contact Fax Number:

**CERTIFIED MAIL - RETURN RECEIPT
REQUESTED**

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from, the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write; please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

KS Scharman
EXEMPT ORGANIZATION
SENIOR REVENUE AGENT

Enclosures:
Publication 892
Publication 3498
Report of Examination

Form 886A	Department of the Treasury - Internal Revenue Service	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		20XX12

LEGEND

ORG = Organization name XX = Date Address = address City = city State = state
 Founder-1, Founder-2 & Founder-3 = 1st, 2nd & 3rd Founder BM-1, BM-2, BM-3 & BM-4 = 1st, 2nd, 3rd & 4th BOARD MEMBERS CO-1, CO-2, CO-3, CO-4, CO-5, CO-6, CO-7 & CO-8 = 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, & 8th COMPANIES

ISSUES:

1. Whether the tax exempt status of the ORG (hereinafter "ORG") as an organization described under I.R.C. section 501(c)(3) should be revoked effective January 1, 20XX, because it was not operated exclusively for charitable purposes and because its earnings inured to the benefit of private individuals and shareholders.
2. In the alternative, whether the ORG should be classified as a private foundation effective January 1, 20XX, since it does not meet the requirements of section 509(a)(3) to be classified as other than a private foundation.

FACTS:

ORG was created with a Declaration of Trust by Founder-1, Founder-2 and Founder-3, collectively called the Trustees (each being a "Founder") on August 17, 19XX. The Trust claimed creation for the purpose of establishing an organization which is described in IRC § 501(c)(3) and IRC § 509(a)(3). The specified supported organizations were listed as follows:

1. CO-1, City, State
2. CO-2, City, State
3. CO-3, City, State
4. CO-4, City, State
5. CO-5, City, State
6. CO-6, City, State
7. CO-7, City, State

The Trust agreement provided that the above seven organizations were to be referred to in the Trust Agreement as "the Supported Organizations." The Dissolution Clause provides:

Upon the dissolution of the Supporting Organization, Trustees shall distribute all remaining assets of the trust estate to one or more of the Supported Organizations which are then duly qualified under Code Section 509(a)(1) or (2) which are Code Section 509(c)(3) organizations, to be used for one or more exempt purposes within the meaning of Code Section 501(c)(3).

The Trust Instrument stated that at no time may the number of Trustees who are not "disqualified persons" as defined in Code Section 4946 be less than a number which is one more than the number of disqualified persons then serving as Trustees. The Declaration of Trust included language whereby the Supporting Organization is prohibited from engaging in any activities that are not in furtherance of the purposes as found under 509(a)(3) and shall not operate to support or benefit any organization other than the Supported Organization. The Declaration of Trust further provides that each year, so long as it meets the integral part test, the Trust may vary the amount of support.

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The Trust states that ORG shall maintain a significant involvement in the Supported Organization to the extent that the Supported Organization will ensure attentiveness because the program it funds will depend upon its support.

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The control of ORG is assured by the Trust Declaration not to reside with any person that may be considered a disqualified person as described under code section 4946. The Trust clearly states that no part of ORG's activities shall be in furtherance of a purpose other than supporting or benefiting one or more of the Supported Organizations. Moreover, the trustees shall be entitled to reasonable compensation to administer the trust, extra compensation for unusual or extraordinary services and reasonable expenses to administer the trust, estimated to be \$.

The Form 1023 application for Exemption from Federal Income Tax was signed by Founder-1, Trustee on August 17, 19XX, for the ORG. With the assurances contained in the Trust Operation, "No part of the activities of the Supporting Organization shall be in furtherance of a purpose other than supporting or benefiting one or more of the Supported Organizations," and, "At no time shall the Supporting Organization be controlled directly or indirectly, by one or more disqualified persons, as defined in Code Section 4946...", the Internal Revenue Service approved ORG for exempt status on March 10, 20XX with a definitive ruling Letter 947. The representations made by the ORG to obtain exemption are as follows:

1. The primary purpose of ORG was to provide a Scholarship Fund for graduating seniors of the CO-1, City, State.
2. Founder-1 will contribute during her lifetime sufficient assets to fund the Scholarship and perhaps other charitable activities.
3. Upon her death, she may leave additional funds to these named charities.
4. The organization will pay 100% of its income to the CO-1 for a scholarship.
5. The school has complete control over the scholarship and since the ORG solely provides the money, in effect the school has control over the scholarship and indirectly the organization.
6. Support will be received in the form of gifts in the amounts of \$ during the years 19XX, 20XX and 20XX1. (A footnote on this page states that no activities will occur until after the organization receives exemption from the IRS.)
7. Other than *de minimus* charges, the sole use of funds will be \$ for scholarships and \$ for legal, accounting and miscellaneous expense.

When the IRS requested confirmation of the lack or presence of any activities being performed, ORG responded by stating that the current bank statement was unavailable and the most recent bank statement of December 19XX showing a balance of \$ was still correct.

By letter dated March 10, 20XX, ORG was recognized by the Service as exempt from Federal income tax under section 501(c)(3) because it is described in section 501(c)(3) and classified as an organization that is not a private foundation because it is described in section 509(a)(3).

Contributions to the Organization

All donations to the organization were made by Founder-1, as follows:

19XX	\$
20XX	\$
20XX	\$

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20XX
20XX
20XX
Total \$

In 19XX, 20XX, and 20XX, the organization paid \$ in premiums on a life insurance policy on Founder-1's life. The organization sold the policy to her son in 20XX for \$, when he became the beneficiary (see details below).

Trustees

None of the trustees had any connection with, or were appointed by, the supported organizations. Founder-1 is the mother of trustee BM-1; she shared a residence with trustee Founder-2.

BOARD OF TRUSTEES 19XX				
19XX	20XX	20XX	20XX	20XX
Founder-1 Address	Founder-1 Address	Founder-1 Address	Founder-1 Address	Founder-1 Address
Founder-2 Address	Founder-2 Address	Founder-2 Address	Founder-2 Address	Founder-2 Address
Founder-3 Address	Founder-3 Address	Founder-3 Address	Founder-3 Address	Founder-3 Address
		BM-1 - City, State	BM-1 - City, State	BM-1 - City, State
		BM-2 - Address	BM-2 - Address	BM-2 - Address

ADVISORY BOARD MEMBERS

BM-3	BM-3	BM-3	BM-3	BM-3
BM-4	BM-4	BM-4	BM-4	BM-4

Income and Expenses on Form 990

	FORM 990 ANALYSIS		
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TAX LINE #		19XX	20XX	20XX	20XX	20XX	20XX	TOTALS
REVENUE								
PART 1 -1	CONTRIBUTIO	\$	\$	\$		\$	FINAL	
		100% of contributions were from Founder-1						
	INVESTMENTS	1	\$	\$	\$	\$	\$	\$
Part 1 -	GROSS RECEIPTS FROM ASSET SALE				\$			\$
	Total Revenue			\$	\$	\$	\$	\$
	+STMT 2 STATES :SALE OF LIFE INS POLICY FOR CSV DATE ACQUIRED							
	TOTAL CASH RECEIPTS							\$

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ORG made the following grants to the designated supported organizations, for their scholarship funds:

	CO-1	CO-2
20XX		
20XX	\$	
20XX		
20XX		
20XX		

The above grants to the designated supported organizations did not confer benefits on insiders to the organization or to family members of insiders to the organization. No other grants were made. The organization did not share, disclose, or transmit financial information with CO-1 or with CO-2.

Life Insurance Policy

In 19XX, ORG purchased a life insurance policy issued by CO-8 (policy POLICY) on the life of trustee Founder-1. The insurance agent who wrote the policy was trustee BM-2. The decision to purchase the policy by the organization was reflected in the August 18, 19XX, minutes. ORG was the beneficiary of the policy. Originally, the policy was for \$ but in 20XX the organization had the benefit reduced to \$ which resulted in lower premiums. The organization paid all the premiums due on the policy in 19XX, 20XX and 20XX in the amounts of \$ \$ and \$ respectively, for a total of \$. This amount is just slightly less than the \$ in contributions made by Founder-1 to the organization in 19XX, 20XX, and 20XX.

The organization sold the policy in 20XX to trustee BM-1 (Founder-1's son) for \$. According to a written statement by CO-8, this was the cash surrender value of the policy. BM-1 then became the beneficiary of the policy.

The 19XX Form 990 disclosed that the organization invested in a life insurance policy, and that the organization was the beneficiary of the policy. The Form 990s for 19XX, 20XX, and 20XX disclosed the life insurance premiums. The 20XX Form 990 disclosed that the policy was sold to BM-1 for the cash surrender value of \$.

The decision to purchase the policy as an investment is reflected in the August 18, 19XX minutes, and the decision to sell the policy was reflected in the October 10, 20XX minutes. The decisions to buy and to sell the policy were made with only three trustees present: Founder-1, Founder-3 and Founder-2.

Personal Use of Organization's Assets for Office and Travel

In the 20XX Form 990, the organization claimed that it paid \$ in travel expenses, and \$ in home office related expenses to its trustees.

However, the organization failed to provide any receipts or source documents to support expenditures for travel or office expenses as ordinary and necessary business expenses, or having an exempt purpose. The organization does not have the required documentation to show how office space was exclusively used for

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the organization at two personal residences of Founder-1. The organization does not have any supporting records for communication expenses, bank records, receipts, travel logs, contemporaneous meetings notes, or agenda.

The following shows the travel expenses the organization paid to its trustees:

Type	EXPENSE	Cost	
TRAVEL EXPENSES			
1/06 - 1/10	BM-3 travels to City from City; Expenses include limo/airfare/per diem		
2/03 - 2/09	BM-4 travels from City to City. Expenses include: Taxi/limo/airfare/perdiem		
9-Mar	Founder-1 travels to board meeting		
9-Mar	Founder-2 travel to board meeting		
5/07- 5/09	Founder-1 travels to City, State to hold meeting with former faculty member, prior to her passing. Expenses include: limo/airfare/per diem		
5/17- 5/19	Founder-1 travels to City Expenses include: auto/lodging/per diem		
5/17- 5/19	Founder-2 travels to City. Expenses include: per diem		
5/16 - 5/20	BM-4 travels from City to City. Expenses include: Taxi/limo/airfare/per diem		
7/10-7/23	Founder-1 travels to City with customary expenses including 5 per diem days		
7/12-7/23	BM-4 travels to City with customary expenses including 5 per diem days		
7/07-7/23	BM-1 travels to City including airfare taxi and car rental and 5 days of per diem		
7/20- 7/27	BM-3 travels to City from City; Expenses include limo/airfare/per diem		
11/21-11-27	Founder-1 travels to City. Expenses include: Taxi/limo/airfare/per diem		
11/21-11-27	Founder-2 travels to City. Expenses include: Taxi/limo/airfare/per diem		
	TRAVEL		

Dissolution

The organization filed its final Form 990 in 20XX, which shows no assets at the end of the year. The 20XX Form 990 showed assets of \$ at the beginning of the year and no assets at the end of the year. The assets were used for pay for the grant to City School and for the "expenses" stated above.

1. Whether the tax exempt status of the ORG as an organization described under I.R.C. section 501(0)(3) should be revoked, because it was not operated exclusively for charitable

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purposes and because its earnings inured to the benefit of private individuals and shareholders.

LAW :

IRC § 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Regulation section 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In order for an organization to qualify for exemption under section 501(c)(3), no part of the organization's net earnings may inure to the benefit of any private shareholder or individual. Regulation section 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

The private benefit standard is based on the operational test in section 501(c)(3) requiring an organization to operate exclusively for exempt purposes. An organization will be regarded as operated exclusively only if it engages "primarily" in activities that accomplish one or more exempt purposes such as those specified section 501(c)(3), and an organization will not be so regarded if more than an "insubstantial" part of its activities does no further an exempt purpose. Treas. Reg. § 1.501(c)(3)-1(c)(1).

The prohibition against operation of an organization for a private benefit is but another way of requiring that an organization to operate exclusively for exempt purposes, i.e., for public benefit. Treas. Reg. 1.501(c)(3)-1(d)(1)(i) and (ii). An organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than private interest. Treas. Reg. 1.501(c)(3)-1(d)(1)(ii). Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

While the Inurement prohibition and the private benefit analysis under the operational test of the Treasury regulations may substantially overlap, the two are distinct requirements which must independently be satisfied.

In Bubbling Well Church of Universal Love, Inc. v. Commissioner, 670 F.2d 104 (9th Cir. 1981), the Ninth Circuit upheld the Tax Court's finding that a church failed to show that no part of its net income inured to the benefit of private individuals. The Church supplied no evidence showing that the payments to its controlling members were reasonable. There was no proof in the record of any regular or substantial

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church activities. "The absence of such evidence supports an inference that the benefits to [insiders] were unreasonable because few employee tasks were performed in return." Id. at 106.

In Better Business Bureau v. United States, 326 U.S. 279 (1945), the United States Supreme Court held that, regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under section 501(c)(3).

In Revenue Ruling 67-5, 1967-1 C.B. 123, where a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation, it was held that the foundation was operated for a substantial non-exempt purpose and served the private interests of the creator and his family. Therefore, the foundation was not entitled to exemption from Federal income tax under section 501(c)(3).

GOVERNMENT POSITION:

ORG's IRC § 501(c)(3) tax exempt status should be revoked, because ORG was not operated exclusively for tax exempt charitable purposes. More than an insubstantial purpose of the Organization was to serve the financial needs of its Founder-1, the founder, substantial contributor and trustee, and her family. ORG was operated to allow Founder-1 to claim a charitable contribution deduction under section 170 for the donations to ORG, to invest over 90% of the assets in a life insurance policy on her life, and to sell that life insurance policy to her son for its cash surrender value. Additionally, the net earnings of the Organization inured to the benefit of insiders when the organization made payments for unsubstantiated travel and home office expenses.

A charity's assets are required to be irrevocably dedicated to charitable purposes. Treas. Reg. § 1.501(c)(3)-1(b)(4). The inurement prohibition serves to prevent the individuals who operate the charity from siphoning off any of a charity's income or assets for personal use. An organization is described in section 501(c)(3) only if no part of its net earnings inures to the benefit of any private shareholder. The inurement prohibition is designed to insure that charitable assets are dedicated to exclusively furthering public purposes. An organization is not operated exclusively for exempt purposes if its net earnings inure to the benefit of private shareholders or individuals.

Inurement can take the form of questionable transactions that have no causal relationship to the organization's exempt purposes but result in some benefit to an insider. The insider is in a position to exercise control over the organization's net earnings as if they were his/her own by using them at will rather than within the limitations of a fiduciary capacity. In effect, the insider is using the public's "net earnings" for his/her own benefit. By using the organization's assets to further the interests of organization insiders, ORG breached the private inurement prohibition.

Although the inurement prohibition is stated in terms of net earnings, it applies to any of a charity's assets that serve the interests of its private shareholders. Harding Hospital, Inc. v. United States, 505 F.2d 1068, 1072 (6th Cir. 1974). If a charity's investments are decided in part by the needs of private interests, the charity may not be operated exclusively for exempt purposes. Western Catholic Church v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980). Even if the transaction is characterized as an investment, when a charity's investments are decided in part by the needs of private interests, the charity is not operating exclusively for exempt purposes. Western Catholic Church v. Commissioner, 73 T.C. 196, 214 (1979), aff'd 631 F.2d 736 (7th Cir. 1980).

Founder-1 contributed a total of \$ to the organization from 19XX to 20XX. In the same period, the Department of the Treasury – Internal Revenue Service

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organization also had a total income from investments in the amount of \$. The organization distributed a total of only \$ to its supported organizations in that period. It conducted no other charitable activities.

The organization used a total of \$ for premiums in 19XX-20XX on a life insurance policy on life, and the organization sold the policy to BM-1, Founder-1's son, for \$ in 20XX. There is no evidence that alternative investments for the Organization were considered by the Board, or that the insurance policy was reviewed by anyone acting in the interests of charity. There is no evidence that the purchase and sale of the life insurance policy was made in a business-like fashion. Accordingly, ORG was operated for a substantial non-exempt purpose. See Revenue Ruling 67-5, 1967-1 C.B. 123.

ORG's net earnings have inured to the benefit of insiders. By deciding to take out a life insurance policy on the life of Founder-1 and to sell that life insurance policy to BM-1, ORG put the interests of insiders above public interests. See Western Catholic Church v. Commissioner, 73 T.C. at 196. ORG's purchase of a life insurance policy and subsequent sale of that interest to BM-1, the donor's son and a Board member, constitutes more than incidental private benefit, which is inconsistent with exempt status. In addition, ORG's unsubstantiated payments for personal travel (\$) and personal home office related expenses (\$) to its trustees constituted prohibited private inurement.

Issue 1 Conclusion:

ORG's status as an organization described under section 501(c)(3) should be revoked, because it did not operate exclusively for exempt purposes and because its assets inured to, and it served the private interests of, its creators and other disqualified persons. The Organization transferred most of its assets to its trustees and its trustee's family. Therefore, the Organization failed to operate exclusively for exempt purposes. ORG's exempt status is revoked effective January 1, 20XX, because this is the year ORG's operations were materially different from the representations than it made in its application for exemption.

ORG did not disclose in its exemption application that it would transfer assets to its founders or that it would operate for private benefit.

2. In the alternative, whether the ORG should be classified as a private foundation, since it does not meet the requirements of section 509(a)(3) to be classified as other than a private foundation.

LAW:

Income Tax Regulations section 1.509(a)-4(c) set forth the organizational test a 509(a)(3) organization must meet:

- (1) *In general.* —An organization is organized exclusively for one or more of the purposes specified in section 509(a)(3)(A) only if its articles of organization (as defined in §1.501(c)(3)-1(b)(2)):
- (i) Limit the purposes of such organization to one or more of the purposes set forth in section 509(a)(3)(A);
 - (ii) Do not expressly empower the organization to engage in activities which are not in furtherance of the purposes referred to in subdivision (i) of this subparagraph;
 - (iii) State the specified publicly supported organizations on whose behalf such

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organization is to be operated (within the meaning of paragraph (d) of this section); and
 (iv) Do not expressly empower the organization to operate to support or benefit any organization other than the specified publicly supported organizations referred to in subdivision (iii) of this subparagraph.

Income Tax Regulations section 1.509(a)-4(e) set forth the operational test a 509(a)(3) organization must meet:

(1) *Permissible beneficiaries.* —A supporting organization will be regarded as "operated exclusively" to support one or more specified publicly supported organizations (hereinafter referred to as the "operational test") only if it engages solely in activities which support or benefit the specified publicly supported organizations. Such activities may include making payments to or for the use of, or providing services or facilities for, individual members of the charitable class benefited by the specified publicly supported organization. ... Similarly, an organization will be regarded as "operated exclusively" to support or benefit one or more specified publicly supported organizations even if it supports or benefits an organization, other than a private foundation, which is described in section 501(c)(3) and is operated, supervised, or controlled directly by or in connection with such publicly supported organizations, or which is described in section 511(a)(2)(B). However, an organization will not be regarded as operated exclusively if any part of its activities is in furtherance of a purpose other than supporting or benefiting one or more specified publicly supported organizations.

Income Tax Regulations section 1.509(a)-4(f) sets forth the nature of relationships required for section 509(a)(3) organizations:

(1) *In general.* —Section 509(a)(3)(B) describes the nature of the relationship required between a section 501(c)(3) organization and one or more publicly supported organizations in order for such section 501(c)(3) organization to qualify under the provisions of section 509(a)(3). To meet the requirements of section 509(a)(3), an organization must be operated, supervised, or controlled by or in connection with one or more publicly supported organizations. If an organization does not stand in one of such relationships (as provided in this paragraph) to one or more publicly supported organizations, it is not an organization described in section 509(a)(3).

(2) *Types of relationships.* —Section 509(a)(3)(B) sets forth three different types of relationships, one of which must be met in order to meet the requirements of subparagraph (1) of this paragraph. Thus, a supporting organization may be:

- (i) Operated, supervised, or controlled by,
- (ii) Supervised or controlled in connection with, or
- (iii) Operated in connection with, one or more publicly supported organizations.

(3) *Requirements of relationships.* —Although more than one type of relationship may exist in any one case, any relationship described in section 509(a)(3)(B) must insure that:

- (i) The supporting organization will be responsive to the needs or demands of one or more publicly supported organizations; and
- (ii) The supporting organization will constitute an integral part of, or maintain a significant involvement in, the operations of one or more publicly supported

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organizations.

Income Tax Regulations section 1.509(a)-4(i) provides that a supporting organization will be considered as being "operated in connection with" one or more publicly supported organizations only if it meets the "responsiveness test" defined in 1.509(a)-4(i)(2) and the "integral part test" defined in 1.509(a)-4(i)(3).

Responsiveness test of 1.509(a)-4(i)(2):

(i) For purposes of this paragraph, a supporting organization will be considered to meet the "responsiveness test" if the organization is responsive to the needs or demands of the publicly supported organizations within the meaning of this subparagraph. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(ii)

(a) One or more officers, directors, or trustees of the supporting organization are elected or appointed by the officers, directors, trustees, or membership of the publicly supported organizations;

(b) One or more members of the governing bodies of the publicly supported organizations are also officers, directors or trustees of, or hold other important offices in, the supporting organizations; or

(c) The officers, directors or trustees of the supporting organization maintain a close and continuous working relationship with the officers, directors or trustees of the publicly supported organizations; and

(d) By reason of (a), (b), or (c) of this subdivision, the officers, directors or trustees of the publicly supported organizations have a significant voice in the investment policies of the supporting organization, the timing of grants, the manner of making them, and the selection of recipients of such supporting organization, and in otherwise directing the use of the income or assets of such supporting organization...

(iii)

(a) The supporting organization is a charitable trust under State law;

(b) Each specified publicly supported organization is a named beneficiary under such charitable trust's governing instrument; and

(c) The beneficiary organization has the power to enforce the trust and compel an accounting under State law.

Integral part test of 1.509(a)-4(i)(3)

(i) For purposes of this paragraph, a supporting organization will be considered to meet the "integral part test" if it maintains a significant involvement in the operations of one or more publicly supported organizations and such publicly supported organizations are in turn dependent upon the supporting organization for the type of support which it provides. In order to meet this test, either subdivision (ii) or subdivision (iii) of this subparagraph must be satisfied.

(iii)

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(a) The supporting organization makes payments of substantially all of its income to or for the use of one or more publicly supported organizations, and the amount of support received by one or more of such publicly supported organizations is sufficient to insure the attentiveness of such organizations to the operations of the supporting organization. In addition, a substantial amount of the total support of the supporting organization must go to those publicly supported organizations which meet the attentiveness requirement of this subdivision with respect to such supporting organization. Except as provided in (b) of this subdivision, the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. In applying the preceding sentence, if such supporting organization makes payments to, or for the use of, a particular department or school of a university, hospital or church, the total support of the department or school shall be substituted for the total support of the beneficiary organization.

(b) Even where the amount of support received by a publicly supported beneficiary organization does not represent a sufficient part of the beneficiary organization's total support, the amount of support received from a supporting organization may be sufficient to meet the requirements of this subdivision if it can be demonstrated that in order to avoid the interruption of the carrying on of a particular function or activity, the beneficiary organization will be sufficiently attentive to the operations of the supporting organization. This may be the case where either the supporting organization or the beneficiary organization earmarks the support received from the supporting organization for a particular program or activity, even if such program or activity is not the beneficiary organization's primary program or activity so long as such program or activity is a substantial one.

(d) All pertinent factors, including the number of beneficiaries, the length and nature of the relationship between the beneficiary and supporting organization and the purpose to which the funds are put (as illustrated by subdivision (iii)(b) and (c) of this subparagraph), will be considered in determining whether the amount of support received by a publicly supported beneficiary organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization. Normally the attentiveness of a beneficiary organization is motivated by reason of the amounts received from the supporting organization. Thus, the more substantial the amount involved, in terms of a percentage of the publicly supported organization's total support the greater the likelihood that the required degree of attentiveness will be present. However, in determining whether the amount received from the supporting organization is sufficient to insure the attentiveness of the beneficiary organization to the operations of the supporting organization (including attentiveness to the nature and yield of such supporting organization's investments), evidence of actual attentiveness by the beneficiary organization is of almost equal importance. An example of acceptable evidence of actual attentiveness is the imposition of a requirement that the supporting organization furnish reports at least annually for taxable years beginning after December 31, 1971, to the beneficiary organization to assist such beneficiary organization in insuring that the supporting organization has invested its endowment in assets productive of a reasonable rate of return (taking appreciation into account) and has not engaged in any activity which would give rise to liability for a tax imposed under sections 4941, 4943, 4944,

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or 4945 if such organization were a private foundation. ... The imposition of such requirement is, however, merely one of the factors in determining whether a supporting organization is complying with this subdivision and the absence of such requirement will not preclude an organization from classification as a supporting organization based on other factors.

(e) However, where none of the beneficiary organizations is dependent upon the supporting organization for a sufficient amount of the beneficiary organization's support within the meaning of this subdivision, the requirements of this subparagraph will not be satisfied, even though such beneficiary organizations have enforceable rights against such organization under State law.

GOVERNMENT'S POSITION:

As set forth above, it is the government's primary position that the tax exempt status of The (the "Organization") should be revoked. Alternatively, the Organization should be reclassified as a private foundation

Due to Congressional concerns about wide-spread abuses of their tax-exempt status by private foundations, private foundations were defined and subjected to significant regulations and controls by the Tax Reform Act of 1969. The definition of a private foundation is intentionally inclusive so that all organizations exempted from tax by IRC § 501(c)(3) are private foundations except for those specified in IRC § 509(a)(1) through (4). Roe Foundation Charitable Trust v. Commissioner, T.C. Memo. 1989-566; Quarrie Charitable Fund v. Commissioner, 603 F.2d 1274, 1277 (7th Cir. 1979). ORG claims it is excepted from private foundation status and not subject to the rules of Chapter 42 applicable to private foundations because it meets the requirements of section 509(a)(3), which defines supporting organizations.

Public charities (organizations described in section 501(c)(3) that meet the requirement of sections 509(a)(1) or (2)) are excepted from private foundation status on the theory that their exposure to public scrutiny and their dependence on public support keep them from the abuses to which private foundations are subject. Supporting organizations that meet the requirements of section 509(a)(3) are excepted from private foundation status on the theory that the public charities that they support, rather than the public, will provide the scrutiny to keep supporting organizations from the types of abuses to which private foundations are prone. Quarrie, 603 F.2d at 1277-78.

Section 509(a)(3) organizations must meet all three of the following tests:

- 1) Organizational and Operational Tests under section 509(a)(3)(A).
- 2) Relationship Test under section 509(a)(3)(B).
- 3) Disqualified Person Control Test under section 509(a)(3)(C).

Overall, these tests are meant to ensure that a supporting organization is responsive to the needs of a public charity and intimately involved in its operations and that the public charity (or publicly supported organization) is motivated to be attentive to the operations of the supporting organization and that it is not controlled, directly or indirectly, by disqualified persons. As set forth below, ORG does not meet either the first or second tests, and thus does not meet the requirements of section 509(a)(3). ORG therefore should

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be reclassified as a private foundation.

Organizational and Operational Tests under section 509(a)(3)(A).

ORG meets the organization test of Treas. Reg. § 1.509(a)-4(c)(1)(Hi) and (iv), because its governing instrument states the specified publicly supported organization(s) on whose behalf it is to be operated, does not expressly empower the organization to support or benefit any organizations other than the specified publicly supported organization(s), and requires that ORG's assets will be distributed only to the designated supported organizations upon termination of the Organization.

ORG does not meet the operational test set forth in Treas. Reg. § 1.509(a)-4(e)(1). A supporting organization will be regarded as "operated exclusively" to support a specified publicly supported organization(s) only if it engages in activities which support or benefit the specified publicly supported organizations(s). As was discussed under the Primary Issue above, the Organization has served private interests and has made payments for the benefit of Founder-1, her other family members, and other trustees. Therefore, the operational test is not satisfied.

Relationship Test under section 509(a)(3)(B).

As set forth in Treas. Reg. § 1.509(a)-4(f)(2), there are three permissible relationships: (i) operated, supervised, or controlled by; (ii) supervised or controlled in connection with; and (iii) operated in connection with one or more publicly supported organizations.

ORG does not meet the requirements of the first or second relationships, because none of the board of trustee members were appointed by the publicly supported organizations, and there is no common supervision or control by the same persons over the Organization and the supported organizations.

ORG does not meet the requirements of the third relationship, because it does not satisfy either the "responsiveness" or the "integral part" test required for that relationship by Treas. Reg. § 1.509(a)-4(i).

The responsiveness test is designed to ensure that the publicly supported organization can influence the activities of the supporting organization. In order to meet the responsiveness test, Treas. Reg. § 1.509(a)-4(i)(2)(ii) or (iii) must be satisfied. ORG did not meet the requirements of Treas. Reg. § 1.509(a)-4(i)(2)(ii) because no board member appointed by the supported organization had a significant voice in the operations of the supporting organization, no member of the board of trustees was appointed by a supported organization, and the board minutes do not reflect any input by a supported organization. Thus, there is no indication that the supported organization had a significant voice in the investment policies of the supported organization or in the timing of grants or the selection of recipients. See Roe Foundation Charitable Trust v. Commissioner, 58 T.C.M. 402 (1989). ORG did not meet the requirements of Treas. Reg. § 1.509(a)-4(i)(2)(iii) because, although it was a charitable trust under state law and each specified publicly supported organization was a named beneficiary under the charitable trust's governing instrument, there is no indication that the beneficiary organizations had the power to enforce the trust and compel an accounting under state law. Therefore, the Organization does not meet either of the responsiveness tests.

The integral part test is designed to ensure that the publicly supported organization will be motivated to attend to the operations of the supporting organization. The integral part test is satisfied if the supporting organization maintains a significant involvement in the operations of one or more publicly supported organizations and the publicly supported organizations are in turn dependent upon the supporting

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organization for the type of support which it provides. Treas. Reg. § 1.509(a)-4(i)(3)(i). In order to meet this test, the requirements of either Treas. Reg. § 1.509(a)-4(i)(3)(ii) or (iii) must be satisfied. Because ORG did not perform any activities for or on behalf of publicly supported organizations, aside from grants, it does not meet the requirements of Treas. Reg. § 1.509(a)-4(i)(3)(ii). As described below, it does not meet the requirements of Treas. Reg. § 1.509(a)-4(i)(3)(iii) either.

Treas. Reg. § 1.509(a)-4(i)(3)(iii) has the following 3 basic requirements: 1) payment of "substantially all" of its income to publicly supported organizations; 2) the amount received by one publicly supported organization must be sufficient to motivate it to pay attention to the operations of the supporting organization; and 3) a substantial amount of the total support of the organization must go to those publicly supported organizations that meet the attentiveness requirement. ORG does not meet these requirements.

Rev. Rul. 76-208, 1976-1 C.B. 161, defined the "substantially all" requirement of Treas. Reg. § 1.509(a)-4(i)(3)(iii) to mean 85% of income. All facts and circumstances are considered in determining whether the "substantially all" requirement is satisfied. While there is no absolute rule with respect to the timing of the distributions, in general a supporting organization will satisfy the "substantially all" requirement if it distributes 85 percent or more of its income to specified publicly supported organizations no later than the end of the year following the year the income is realized. Generally, income for purpose of applying the 85 percent test is reduced by related expenses and excludes contributions received and long-term capital gains. Also, consistent with section 53.4942(a)-3(e) of the private foundation excise tax regulations, a supporting organization may carryover excess distributions for five years following the year in which the excess distribution was made.

Although ORG met the 85% test for 20XX 20XX, and 20XX, it did not meet the test in 20XX or later years. In 20XX, ORG had income (excluding contributions) of \$, To meet the 85% requirement, ORG would have had to pay out \$ no later than the end of 20XX. Even with the carryover of earlier excess distributions, ORG did not meet the integral part test.

	Income	Distributions	required distribution for the following year	carryover
20XX				
20XX				
20XX				
20XX				
20XX				

Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a) provides that the amount of support received by a publicly supported organization must represent a sufficient part of the organization's total support so as to insure such attentiveness. Generally, grants or distributions of amounts that are less than 10 percent of the publicly supported organization's total support are insufficient to insure the publicly supported organization's attentiveness. Treas. Reg. § 1.509(a)-4(i)(3)(iii)(b) provides that a supporting organization can meet the attentiveness requirement, even where the amount of support received by the publicly supported

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organization does not represent a sufficient part of the publicly supported organization's total support, if it can be demonstrated that support is earmarked for a substantial program of the publicly supported organization that would be interrupted without the supporting organization's support. All pertinent factors, including the percentage of income received from the supporting organization and evidence of actual attentiveness, will be considered in determining whether the amount of support received by a publicly supported organization is sufficient to insure the attentiveness of such organization to the operations of the supporting organization." Treas. Reg. § 1.509(a)-4(i)(3)(d). Furthermore, where none of the beneficiary organizations is dependent upon the supporting organization for a sufficient amount of the beneficiary organization's support within the meaning of this subdivision, the requirements of this subparagraph will not be satisfied, even though such beneficiary organizations have enforceable rights against such organization under State law. Treas. Reg. § 1.509(a)-4(i)(3)(e).

ORG failed to provide evidence that its support of CO-1 or CO-2 was sufficient to cause the supported organizations to be motivated to attend to the organization's operations. ORG failed to produce any evidence that its support was a substantial program of the publicly supported organization. There was no evidence that shows that CO-1 or any other supported organization were actually attentive, for example, that they participated in any board meeting or were involved in decisions regarding investments and/or operations of the organization. ORG did not even share, disclose, or transmit financial information with its supported organizations. Thus, ORG fails the integral part test.

As ORG fails both the responsiveness test and the integral part test required under Treas. Reg. § 1.509(a)-4(i), it is not "operated in connection with one or more publicly supported organizations," and fails the relationship test under section 509(a)(3)(B).

Issue 2 Conclusion:

ORG does not qualify as a supporting organization under section 509(a)(3) because it fails the operational and relationship tests required by the regulations under that section. The sale of the life insurance policy to BM-1 indicates that ORG's board was indirectly controlled by disqualified persons at least as of that date. This constitutes a material change from ORG's application for exemption, thus reclassification as a private foundation is effective as of January 1, 20XX.

CONCLUSION:

The Organization's tax exempt status should be revoked because it is not an organization described in section 501(c)(3). Alternatively, the Organization should be reclassified as an organization that is a private foundation defined in section 509(a). This determination is effective January 1, 20XX.